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UNCLAS SECTION 01 OF 02 QUITO 000611

SIPDIS

SENSITIVE

PASS USTR BENNETT HARMAN

E.O. 12958: N/A

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SUBJECT: PROCURADOR BORJA PRONOUNCES ON OXY CASE

REF: QUITO 601

1. (SBU) Summary. Procurador General Borja met with Embassy officers on March 16 and explained his position on Occidental Petroleum (Oxy). Borja stated that the caducity (contract nullification and nationalization of Oxy's assets) and arbitration issues should be treated separately. He did not answer why he sent the official notice (oficio) to PetroEcuador on March 14 (reftel), but said all he was looking for from PetroEcuador was a report of what PetroEcuador had done over the last six months since Borja requested that PetroEcuador declare caducity. He claimed that there were strong legal grounds for declaring caducity and that PetroEcuador had sufficient time to act on the matter. Borja could not specify what damages Ecuador had suffered as a result of Oxy's alleged breach of contract. We explained that it would be less costly for the parties to negotiate and avoid another arbitration. Acknowledging that a declaration of caducity is not imminent, he said Oxy should sit down with PetroEcuador and work out a resolution. His role would be to review that agreement and present it to the Congress for approval, both dubious prospects. End summary.

Riding His High Horse

2. (SBU) Procurador General (Solicitor General equivalent) Jose Maria Borja met with Embassy officers March 16, at the Embassy's request. He began his case by forcefully asserting that Oxy's VAT arbitration case (where Oxy was awarded \$75 million in July 2004) must be kept separate from Oxy's alleged contracts violations and the Procurador's demand that Oxy's contract be declared void (caducity) and Oxy's assets taken by the state. Borja claimed the arbitration panel in the VAT case had no jurisdiction to hear the matter because it was a tax case with no confiscation of assets involved. We reminded Borja that the arbitration panel had already reviewed and rejected those arguments and that arbitral decisions are only overturned in the most extreme cases. Though asked, Borja never answered why he chose March 14 to send the oficio to PetroEcuador (reftel) demanding action on his request to declare caducity.

3. (SBU) We explained that the parties had been in discussions to resolve their problems. We added that a declaration of caducity would likely cause Oxy to bring yet another arbitration case against the GOE, which would be costly for everyone. Washington was also concerned, we noted. Borja seemed aware of the Ambassador's and Washington's concerns, stating that he met the night before with Minister of Economy on the matter.

4. (SBU) Borja said that he was acting as the protector of the state and that we should bear in mind that Ecuador had its sovereign rights. We agreed about national sovereignty, pointing out that the United States had its sovereign rights when it came to negotiating free trade agreements.

5. (SBU) We asked Borja how Ecuador had been damaged by Oxy's alleged breach of contract. With respect to the supposedly illegal transfer of 40% Oxy's interest in Block 15 to Canadian oil company EnCana in 2000, we noted that Ecuador actually stood to gain more now than had Oxy received the required permission from the Minister of Energy for the alleged 2000 transfer. Oil prices now were much higher than they were in 2000. Borja responded that Ecuador did not have to show that it was damaged in any way. The fact that Oxy failed to get the Minister of Energy's permission before the alleged transfer was sufficient reason to seize Oxy's assets. In response to our question, Borja asserted that the legal concept of a penalty appropriate to the offense (proportionality) was limited to criminal, not civil cases, as was Oxy's case.

The Way Forward

6. (SBU) Borja said that there were two ways forward: declare caducity, or PetroEcuador sits down with Oxy and works out an "administrative" resolution. Agreeing that negotiation seemed the best resolution, we said that Oxy told us they

were willing to sit down with PetroEcuador. Still, we noted 10 days (the period the Procurador gave PetroEcuador to respond to the oficio) was not much time for the parties to reach a resolution. Borja said he was not looking for a resolution within 10 days or a declaration of caducity. What he wanted within 10 days was a report from PetroEcuador as to what PetroEcuador had done for the past six months to respond to his request for caducity.

17. (SBU) If the PetroEcuador and Oxy reached an agreement, he would review it for legal sufficiency, as was his duty, he said. Borja bombastically added that he would not approve any "under the table" deals. We responded that neither would Oxy accept such an under the table deal. After we noted that there was a way forward for negotiations to proceed, Borja added that he would then bring the agreement to the Ecuadorian Congress for approval. We noted that the Ecuadorian Congress at this point was having a rather difficult time agreeing on anything, let alone a deal between the state and a private oil company. Bursting with hubris, Borja responded that whenever he brought something to the Ecuadorian Congress that he had received "unanimous" approval from them. We congratulated him.

Comment

18. (SBU) The good news is that a declaration of caducity is not imminent (besides, as Borja admitted to us, he does not have the legal authority to declare caducity on his own). Also, Borja agrees that Oxy should negotiate with PetroEcuador. The bad news is that eventually the final resolution will have to go through Borja, and we will need to address his idea to involve the Ecuadorian Congress. We think Oxy should take advantage of this small window of opportunity to start serious negotiations with PetroEcuador President Hugo Bonilla. At the same time, Embassy and Washington officials must continue to pressure the GOE to seriously negotiate and remind them that once a resolution is reached we can work with the GOE to present the negotiated resolution in the best light - a win for everyone.

KENNEY